

Memorandum

TO: HONORABLE MAYOR AND CITY
COUNCIL AND THE BOARDS OF
ADMINISTRATION FOR THE CITY'S
RETIREMENT PLANS

FROM: Alex Gurza
Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: September 3, 2013

Approved



Date

9/9/13

**SUBJECT: EARLY RETIREE REINSURANCE PROGRAM AND RELATED
APPROPRIATION ORDINANCE AND FUNDING SOURCES
RESOLUTION AMENDMENTS IN THE BENEFITS FUND**

RECOMMENDATION

- (a) Adopt a resolution authorizing the City Manager to disburse funds received from the United States Department of Health and Human Services (HHS) for the Early Retiree Reinsurance Program (ERRP) in the amount of \$2,798,589 to offset future Blue Shield medical plan premium increases for the City, Retirement Funds and active employees and retirees (plan participants) in the 2013 calendar year. Funds will be disbursed to the City, Retirement Funds and Blue Shield plan participants in accordance with the percentage distribution of the premium costs for Blue Shield over the last five years.
- (b) Adopt the following 2013-2014 Appropriation Ordinance and Funding Sources Resolution amendments in the Benefits Fund:
 - (1) Eliminate the Early Retirement Reinsurance Program Reserve in the amount of \$2,793,988;
 - (2) Decrease the estimate for Transfer of City Funds to the Benefits Fund for Health Plan Premiums by \$986,503;
 - (3) Establish a Transfer to the: Federated Retirement Fund in the amount of \$637,798;
 - (4) Establish a Transfer to the: Police and Fire Retirement Fund in the amount of \$845,454;
 - (5) Establish an appropriation to the Human Resources Department for: ERRP Blue Shield Active Employee Premium Reductions in the amount of \$323,834; and
 - (6) Decrease the Ending Fund Balance in the amount of \$4,601.

OUTCOME

The ERRP is intended to help employers maintain early retiree health care programs as part of federal health care reform. Approval of the recommendation will result in successful disbursement of the funds entrusted to the City for the ERRP.

EXECUTIVE SUMMARY

On June 1, 2010, the Patient Protection and Affordable Care Act (PPACA) provided \$5 billion to establish the ERRP to encourage plan sponsors to continue providing health insurance to early retirees who are age 55 and older but are not yet eligible for Medicare. The ERRP provides reimbursement to participating employment-based plans for a portion of the costs of health benefits for early retirees. Funds received through the ERRP can only be used to offset future costs for health benefits. ERRP funds cannot be used as general revenue. The applications submitted to HHS for the Blue Shield of California (Blue Shield) and Kaiser Permanente (Kaiser) medical plans authorized the City to use the ERRP funds to offset future increases in health benefit costs for the City, Retirement Funds and plan participants. If a plan sponsor (such as the City) chooses to use some or all of its ERRP proceeds to reduce plan participant costs (e.g., premium contributions, copayments, deductibles, etc.), it must do so for all plan participants, including active employees and Medicare retirees, and not just "early retirees." The term "early retiree" refers to retirees who are under the age of 65. The City only received funds from the ERRP based on claims submitted under the Blue Shield application. Therefore, based on this information, it is recommended that ERRP funds be used to offset Blue Shield medical plan premium costs for the City, Retirement Funds and Blue Shield plan participants.

The average premium cost distribution between the Blue Shield active plans and the retirement plans over the last five years is 47% and 53% respectively. In addition, in 2013 the City's portion of the active plans is 75% and the employees' portion is 25%; the Retirement Funds' portion is approximately 76% and retirees' portion is approximately 24%. As such, staff recommends using this same percentage split to determine how much ERRP funds will be distributed to the City, Retirement Funds and Blue Shield plan participants.

If the above recommendations are approved, the City's active employee medical benefits account will receive \$986,503, the Federated Retirement Fund will receive \$637,798 (\$146,693 to be disbursed to retirees and \$491,165 to offset plan premium costs), the Police and Fire Retirement Fund will receive \$845,454 (\$202,909 to be disbursed to retirees and \$642,545 to offset premium costs), and active employees enrolled in the City's Blue Shield plan will receive \$328,834. As noted previously, these funds must be used to offset health benefit costs as required by the ERRP regulations.

BACKGROUND

Rising costs have made it difficult for many employers to provide quality, affordable health insurance for workers and retirees. The ERRP was established through the PPACA and is

administered by HHS to encourage plan sponsors to continue providing health insurance to early retirees who are age 55 and older but are not yet eligible for Medicare. The ERRP went into effect on June 1, 2010 and \$5 billion was allocated to the program using federal funding to reimburse participating employment-based plans for a portion of the costs of health benefits for early retirees and early retirees' spouses, surviving spouses, and dependents. The program was slated to end on January 1, 2014, or until funds ran out, which occurred in 2012.

In order to be approved by HHS to participate in the ERRP, an employer had to meet the following requirements:

- Include programs and procedures that have generated or have the potential to generate cost savings for plan participants with claims for chronic and high cost conditions (i.e., conditions for which \$15,000 or more in applicable claims are likely to be incurred during a plan year).
- Have a written agreement in place with its health insurance issuer or plan regarding disclosure of information, data, documents and records to HHS, and have required disclosures made to HHS.
- Ensure that policies and procedures are in place to protect against fraud, waste and abuse under the plan, and comply with requests from HHS for documentation of these programs and their effectiveness.
- Be certified by the Secretary of HHS, which is achieved through the submission of an application.

The ERRP also provides specific limitations regarding how plan sponsors (such as the City) can use the funds that are reimbursed to them through the program. The funds cannot be used as general revenue by a plan sponsor because ERRP is intended to help employers maintain early retiree programs until "healthcare exchanges," where individuals will be able to purchase health care plans that are eligible for federal subsidy, become available in 2014.

Additionally, the ERRP regulations require that the plan sponsor maintain its level of contribution to the plan, net of any ERRP funds, as it did before the ERRP program. This requirement is referred to as the "maintenance of contribution" or MOC requirement. To meet this requirement, the plan sponsor must spend at least the same on premium contributions, net of any ERRP funds, as it did for the baseline year for as long as it holds ERRP funds. The baseline year is defined as the plan year before the application for ERRP funds was submitted to HHS; for the City the baseline year is calendar year 2009.

On December 30, 2010, staff was notified that the City's ERRP applications were approved by HHS. Staff began working with Blue Shield and Kaiser to submit claims information to HHS to determine the reimbursement amount available to the City. For clarification, plan sponsors that applied and were approved by HHS for ERRP funds could receive reimbursement of up to 80% of the costs of medical plan claims between \$15,000 and \$90,000 which were incurred on or after June 1, 2010 for early retirees. Based on submitted information, HHS determined that the City was eligible to be reimbursed \$2,789,622, which was 80% of the value of all eligible claims submitted by Blue Shield for the 2010 and 2011 calendar years. This funding was received in two allotments, one in April 2011 and one in December 2011. The total amount of ERRP funds

has grown to \$2,798,589 due to interest accrued since 2011. The \$5 billion for the ERRP was expended before the claims for the City's Kaiser plan could be processed; therefore, no funds were reimbursed for those claims.

ERRP guidance permits the City to use ERRP funds received for the Blue Shield plan for both the Blue Shield plan and Kaiser plan, as long as the City meets the MOC requirement for each plan. Although both plans were approved by HHS and the City can meet the MOC requirement for each plan, it is recommended that ERRP funds be used to offset future premium costs for only the Blue Shield plan since funds were received only under the Blue Shield application. Furthermore, by using the funds to offset future premium costs for the Blue Shield participants only, the funds cannot be confused as income to plan participants, which has tax implications for the retirement plans.

ANALYSIS

The City of San José Human Resources Department applied for ERRP funds in an effort to offset expenditures associated with providing health benefits to plan participants. The City has worked in close collaboration with the City's benefits consultant, Buck Consultants, to determine whether the City met the MOC requirement and to determine the appropriate use for the funds received, based on the ERRP statute, regulations and guidance.

To meet the MOC requirement, the plan sponsor must spend at least the same on premium contributions, net of any ERRP funds, as it did for the baseline year for as long as it holds ERRP funds. To calculate whether the City met the MOC, medical plan premium expenses were compared for the City, the Retirement Funds, and plan participants for each calendar year from 2009 through 2013 estimates. After careful calculation and review, it was determined that the City met the MOC requirement under the Per Capita Spending Trend Total Dollars Methodology for the Blue Shield plan, as shown in the chart below, and can move forward with utilizing the funds as permitted.

Year	Total Premium Cost	Enrollment	Total Cost per Capita
2009	\$46,306,059	3,722	\$12,441
2010	\$49,349,466	3,641	\$13,554
2011	\$47,536,204	3,462	\$13,731
2012	\$45,882,896	3,337	\$13,750
2013	\$46,662,740	3,302	\$14,132
2013 net of ERRP Funds	\$43,864,151	3,302	\$13,284

Use of Funds

The City may use the funds to offset increases in future health benefit costs such as premium contributions, copayments, deductibles, and/or coinsurance for Blue Shield plan participants, the City and the Retirement Funds. Blue Shield plan participants consist of active employees and

retirees (both under age 65 and over age 65) who are enrolled in the City-sponsored Blue Shield plan.

Offsetting future premium cost is the most administratively feasible option allowed by the ERRP. Offsetting future premium cost can be administered through multiple premium reductions for Blue Shield plan participants, which would ensure that all ERRP funds will be disbursed in the 2013 calendar year.

Alternatively, offsetting costs for copays, coinsurance, and deductibles would require Blue Shield plan participants to submit receipts for reimbursement and additional staff time would be required to process individual reimbursements. It would take longer and cost more to disburse the funds using this method, which may cause the City to continue to hold ERRP funds into the 2014 calendar year.

Based on available options, it is recommended that the funds be used to offset future premium costs for the City, Retirement Health Care Trust Funds and Blue Shield plan participants. For Blue Shield plan participants, it is recommended that the offset of future premium costs be administered through multiple premium reductions.

Distribution of ERRP Funds between the City, Retirement Medical Trust Funds and Blue Shield Plan Participants

The ERRP funds must be used to offset the health benefit premium costs of the City, Retirement Funds, and Blue Shield plan participants. It is recommended that the split of funds between these groups represent the average premium contribution split among the City, Retirement Funds and Blue Shield plan participants over the past five years, which is approximately 35% for active City funds, 41% for Retirement Funds, 12% for active employees and 12% for retirees.

The table below shows how the funds will be distributed.

Entity	Amount of ERRP Funds Received
City Benefits Fund	\$986,503
City Active Employees	\$328,834
Federated Retirement Fund (Retiree Healthcare)	\$491,105
Federated Retirees	\$146,693
Police and Fire Retirement Fund (Retiree Healthcare)	\$642,545
Police and Fire Retirees	\$202,909
Total	\$2,798,589

Active employee and retiree Blue Shield plan participants will receive approximately 24% of the ERRP funds, in the amount of \$678,436 in the 2013 calendar year. Offsets to future premium costs will be pro-rated based on premiums paid and will be reflected on paychecks as a premium reduction. Following an e-mail notification, active full-time employees will receive the premium reductions over two pay periods (100% premium reduction for the first pay period and approximately 64% premium reduction for the second pay period). Active part-time employees

will receive a premium reduction equal to the full-time employee premium reduction for the same plan. Retirees will receive the premium reductions in one monthly retirement payroll check.

EVALUATION AND FOLLOW-UP

This memo provides information and a recommended resolution to resolve outstanding ERRP funding and distribution issues, which were previously addressed in a memo submitted to the Honorable Mayor and City Council on June 21, 2011 (agenda item number 3.10).

PUBLIC OUTREACH/INTEREST

- ☒ **Criteria 1:** Requires Council action on the use of public funds equal to \$1,000,000 million or greater. **(Required: Website Posting)**
- ☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets Criterion 1 above. Therefore, this memorandum will be posted on the City's website for the September 24, 2013 City Council Agenda.

COORDINATION

This memo has been coordinated with the Office of the City Attorney and the Department of Retirement Services.

COST SUMMARY/IMPLICATIONS

Funding for the ERRP program of \$2,800,000 from HHS is currently reserved in the Benefits Fund. The disbursement of these funds, according to the recommendations contained in this memo, will result in a reduction to the City's and Retirement Funds' share of Blue Shield medical plan premium costs for the 2013 plan year of approximately 6% for both retirees and active employees. Savings that result from the reduction to the City's 2013 Blue Shield medical plan premium costs will be taken into consideration as part of the 2013-2014 fund balance calculation that will be factored into the development of the 2014-2015 budget.

The elimination of the ERRP reserve is offset by a transfer of \$637,798 to the Federated Retirement Fund for disbursement to Federated retirees (\$146,653) and to offset plan premium costs (\$491,165), a transfer of \$845,454 to the Police and Fire Retirement Fund for disbursement to Police and Fire retirees (\$202,909) and to offset future plan premium costs (\$642,545), the creation of an appropriation of \$328,834 for ERRP Blue Shield active employee premium reductions, a reduction in the estimated Transfer from City Funds in the amount of \$986,503 to reflect the anticipated savings in the City's share of 2013 premiums, and a reduction in the ending fund balance of the Benefits Fund to account for interest earnings in 2012-2013 that are not yet reflected in the budgeted Reserve.

BUDGET REFERENCE

The table below identifies the funds and appropriations impacted by the recommendation as part of this memo for the 2013-2014 fiscal year.

Fund #	Appn. #	Appn. Name	Total Appn.	Recommended Adjustment	Proposed 2013-2014 Budget Page*	Last Budget Action (Date, Ord. No.)
160	R003	Transfers-Health Benefits	\$63,777,000	(\$986,503)	XI-8	6/18/13, 29271
Total Source of Funds			\$63,777,000	(\$986,503)		
160	NEW	Transfer to Federated Retirement Fund	N/A	\$637,798	N/A	N/A
160	NEW	Transfer to Police and Fire Retirement Fund	N/A	\$845,454	N/A	N/A
160	NEW	ERRP Blue Shield Plan Active Employee Premium Reduction	N/A	\$328,834	N/A	N/A
160	8309	ERRP Ending Fund Balance	\$2,793,988	(\$2,793,988)	XI-9	6/18/13, 29271
160	8999	Ending Fund Balance	\$921,293	(\$4,601)	XI-9	6/18/13, 29271
Total Use of Funds			\$3,715,281	(\$986,503)		


* The 2013-2014 Budget was adopted on June 18, 2013.

CEQA

Not a project, File No. PP10-069 (b), personnel related decisions.



ALEX GURZA
Deputy City Manager



JENNIFER A. MAGUIRE
Budget Director

For questions, please contact Rhonda Schmidt, Senior Analyst, at (408) 975-1430.